

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Southern Union Company

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D.T.E. 02-27

BRIEF OF SOUTHERN UNION COMPANY

Submitted by:

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BRIEF OF SOUTHERN UNION COMPANY

I. INTRODUCTION

On April 16, 2002, Southern Union Company (“Southern Union” or the “Company”)¹ filed a petition (the “Petition”) with the Department of Telecommunications and Energy (the “Department”) for approval and authorization, pursuant to G.L. c. 164, §§ 11 and 14, to issue and distribute up to an aggregate of 10.0 million shares of common stock as a dividend to the Company’s equity shareholders in 2002, 2003, and 2004. Of the 10.0 million shares, the Company seeks approval to issue and distribute not more than 3.0 million shares for the stock dividend in 2002 (i.e., approximately 5 percent of the Company’s outstanding stock as of March 31, 2002), in accordance with a vote by the Company’s Board of Directors scheduled to occur on or about June 1, 2002. In the interest of administrative efficiency, and to avoid the timing constraints inherent in obtaining annual Department approvals for stock dividend issuances for 2003 and 2004, the Company seeks authorization to issue and distribute the remaining 7.0 million shares for the purpose of effecting stock dividends in 2003 and 2004. The

¹ On September 28, 2000, Southern Union Company, a Delaware corporation with its principal offices located in Austin, Texas, completed its acquisition of Fall River Gas Company (“Fall River”) and Providence Energy Corporation and its operating subsidiary, North Attleboro Gas Company (“North Attleboro”). On December 19, 2001, Fall River and North Attleboro began operating as the New England Gas Company.

issuance and distribution of those shares must be approved and authorized by a vote of the Board of Directors.

As discussed herein, the record in this proceeding shows that the Company has met the Department's two-part standard under G.L. c. 164, §§ 14 and 16 for the approval and authorization of a common stock issuance. Accordingly, the Department should approve the Company's request to issue up to 10.0 million shares of common stock for the purpose of providing a dividend distribution to the Company's equity shareholders in 2002, 2003, and 2004.

II. PROCEDURAL HISTORY

On May 13, 2002, the Department conducted a public and evidentiary hearing at its offices. At the evidentiary hearing, the Company presented one witness: Richard N. Marshall, Treasurer and Director of Investor Relations at Southern Union, who testified in support of the Company's request for authorization to issue up to an aggregate of 10.0 million shares of common stock in 2002, 2003, and 2004.

In addition to the sworn testimony presented at the hearing, the evidentiary record consists of approximately 47 documentary exhibits, including the initial filing and the Company's responses to information and record requests. This brief is filed in accordance with the schedule established by the Hearing Officer.

III. DESCRIPTION OF THE PROPOSED STOCK ISSUANCE

A. Issuance of Common Stock

In this filing, Southern Union seeks authorization under G.L. c. 164, §§ 11 and 14 for the issuance and distribution of up to an aggregate 10.0 million shares of common stock for the

purpose of effecting a stock dividend in 2002, 2003, and 2004, with not more than 5 percent of the shares to be issued each year (Exh. SU-1, at 2). Based on approximately 54,844,000 shares of common stock outstanding as of March 31, 2002, the issuance of up to 3.0 million shares would constitute a 5 percent common-stock dividend to shareholders (Exh. SU-4 [Supp.], at 3).² The Company also currently anticipates distributing a 5 percent dividend in 2003 and 2004, consistent with past practice (Exh. SU-1, at 3).

Southern Union initiated its stock dividend policy in 1994 following a corporate reorganization and has issued a stock dividend in each of the past eight years (id. at 4; Tr. at 7). Generally, the Board of Directors has declared the dividend in June of each year as a percentage of outstanding shares of stock (Exh. SU-1, at 4-5). In declaring the dividend, the Board also sets a record and payment date and authorizes the issuance of shares to accomplish the stock dividend (id.). The stock dividend is announced to shareholders on the declaration date and is paid to all holders of Southern Union stock as of the record date, which is generally set 10 days after the declaration date (id. at 5). The payment date generally follows the record date by 10 days to two weeks (id.).

The Company has in place a Stock Dividend Sale Plan (the “Sale Plan”), which provides eligible owners of the Company’s common stock the opportunity to convert shares

² As noted at the evidentiary hearing, the stock dividend is not distributed to shares of treasury stock, which are reflected in the 54,844,000 shares of common stock issued on the consolidated balance sheet (Tr. at 38). However, the dividend must be distributed to outstanding stock options and warrants, which are not reflected in the shares outstanding of 54,844,000 until exercised by the holder (id.). Thus, in order to assure that the Department’s approval is received for a sufficient number of shares to accomplish the dividend, the Company estimates the number of shares that will be necessary as 5 percent of the 54,844,000 shares issued. Following the issuance, the

(footnote continued...)

that are received as a dividend into cash (id. at 7; Tr. at 79-81). Under this plan, shareholders may elect, at a point prior to the record date, to sell shares that are issued to them as a dividend through the Sale Plan (id.). There are no costs to the shareholders associated with this election (id.). The Sale Plan is administered by a Plan Broker, who aggregates the dividend shares offered for sale and sells the shares on the open market over an extended time period of two-to-four weeks (id.). Shareholders participating in the Sale Plan receive payment for their shares based on the average price obtained for the aggregated shares over the allotted time period (id.). However, the record shows that the vast majority of the Company's shareholders do not participate in the Sale Plan (Exh. SU-1 at 7). In 2001, for example, only 99,997 out of 2,555,719 shares issued by the Company (i.e., approximately 3.9 percent) were sold by shareholders as part of the Sale Plan (id.).

The distribution of dividend shares is made to existing shareholders as of the record date on a pro rata basis, so that the percentage of ownership held by each shareholder is unchanged by the issuance (id.). The issuance of the additional shares does not change the total of the common stockholders' equity section of the balance sheet. This ensures that the total value of the Company owned by existing shareholders' is not affected by the stock dividend, which for the Department's purposes, is similar to the effect of a stock split (id.). In addition to Massachusetts, Southern Union operates in Texas, Rhode Island, Missouri, and Pennsylvania

(...footnote continued)

Company will certify to the Department the exact number of shares that have been issued to accomplish the dividend, which will not exceed 3.0 million in 2002.

(id. at 2, 8). Other than Massachusetts, only Pennsylvania requires the Company to obtain state regulatory approval to declare a stock dividend.³

As discussed below, the record shows that the Company's proposal meets the requirements of the Department's two-pronged test for the approval of stock issuances, and therefore, the Company's petition should be granted subject to certification of the Board of Director's vote authorizing the issuance of stock for the purpose of effecting a stock dividend.

B. Capital Structure of the Company

As of March 31, 2002, the Company's adjusted net utility plant in service was \$2,172,148,000, less accumulated depreciation of \$794,692,000, resulting in net utility plant of \$1,377,456,000, plus gas inventories held by regulated utilities in the amount of \$74,370,000 (Exh. SU-3 [revised]). As of March 31, 2002, the Company reported a total capitalization of \$1,266,791,000 (id.), which consists of: (1) long-term debt of \$856,012,000;⁴ and (2) common stock of \$410,779,000 (id.). As described below, this calculation of total capitalization reflects two categories of adjustments that result in a reduction to the capitalization reported on the consolidated balance sheet of \$755,498,000 (Exh. SU-3 [revised]). Accordingly, Southern Union's net-utility plant as of March 31, 2002 will be in excess of total capitalization by \$146,797,000, following the proposed issuance of up to 10.0 million shares of common stock and the distribution of the stock dividend (id.).

³ On June 21, 2001, the Pennsylvania Public Utility Commission approved the Company's request to issue annual stock dividends in 2001, 2002, and 2003 (Exh. SU-11).

⁴ This total includes \$100 million in preferred securities that the Department has determined should be included as long-term debt in calculating the net plant test. See, Southern Union Company, D.T.E. 01-80 (2001).

As noted above, the Company has made two categories of adjustments to the total capitalization set forth in the consolidated balance sheet, consistent with the Department's decisions in Southern Union Company, D.T.E. 01-32 (2001), Southern Union Company, D.T.E. 01-52 (2001), and Southern Union Company, D.T.E. 01-80 (2001). These adjustments, which reduce total capitalization, total \$755,498,000 and consist of: (1) the portion of debt and equity associated with plant-in-service held by unregulated operations (\$42,109,000);⁵ and (2) the portion of debt and equity associated with the removal of goodwill from overall capitalization (\$713,389,000) (Exh. SU-1, at 12-14).

IV. STANDARD OF REVIEW

G.L. c. 164, § 11 requires Department approval as a condition for issuance of stock for the purpose of scrip or stock dividends. The Department has determined that the standard of review to be applied when investigating the appropriateness of the issuance of stock for the purposes of a stock dividend will be the same standard used for financing petitions made by companies under G.L. c. 164, § 14. Southern Union Company, D.T.E. 01-52 (2001). Applying this principle, the Department determined that petitions filed pursuant to G.L. c. 164, § 11 would be approved, if the proposed issuance satisfies the Department's requirements pursuant to G.L. c. 164, §§ 14 and 16. Specifically, for the Department to approve the

⁵ As shown on Exhibit SU-3 [revised], the Company has total plant-in-service of \$2,263,767,000, less accumulated depreciation of \$812,358,000, which results in net plant-in-service of \$1,451,409,000. From this amount, the Company has deducted \$91,619,000 from plant-in-service, less accumulated depreciation of \$17,666,000 (or \$73,953,000) associated with unregulated operations (Exh. SU-3 [revised]).

issuance of stock, bonds, coupon notes or other types of long-term indebtedness⁶ by an electric or gas company, the Department must determine that the proposed issuance satisfies two requirements. First, the Department must assess whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Boston Edison Company, D.T.E. 00-62, at 2 (2000); Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II"), citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department must determine whether the Company has met the net plant test.⁷ Colonial Gas Company, D.P.U. 84-96 (1984).

The Supreme Judicial Court has found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946). In cases where no issue exists about the reasonableness of management decisions regarding the requested financing, the Department limits its section 14 review to the facial reasonableness of the purpose to which the

⁶ "Long-term" refers to periods of more than one year after the date of issuance. See, e.g., Boston Edison Company, D.T.E. 00-62, at 2, fn.2.

⁷ The net plant test is derived from G.L. c. 164, § 16. When the Department approves an issue of new stock, bonds or other securities by a gas or electric company, if it determines that the fair structural value of the plant and of the land and the fair value of the nuclear fuel, gas inventories or fossil fuel inventories owned by such company is less than its outstanding stock and debt, it may prescribe such conditions and requirements as it deems best adapted to make good within a reasonable time the impairment of the capital. See G.L. c. 164, § 16.

proceeds of the proposed issuance will be put. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990). Regarding the net plant test, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

V. THE COMPANY'S PROPOSAL MEETS THE DEPARTMENT'S STANDARD OF REVIEW UNDER G.L. c. 164, §§ 11, 14 and 16.

As set forth above, the Company has the burden in this proceeding to demonstrate that the common-stock issuance: (1) is reasonably necessary to accomplish a legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14; and (2) that the its net utility plant equals or exceeds its total capitalization (as determined by application of the Department's net-plant test) and will continue to do so following the proposed issuance, pursuant to G.L. c. 164, § 16. See New England Power Company, D.T.E. 00-53, at 10; Boston Edison Company, D.T.E. 00-62, at 9-10. In this proceeding, the Company has satisfied this burden, and therefore, the Department should authorize and approve the Company's request to issue up to an aggregate of 10.0 million shares of common stock as a dividend payment to the Company's equity shareholders in 2002, 2003, and 2004, of which not more than 3.0 million shares would be issued for the purpose of effecting the stock dividend in 2002.

A. The Company Has Demonstrated That the Issuance Is Reasonably Necessary to Accomplish a Legitimate Utility Purpose

The record shows that the issuance and distribution of up to an aggregate of 10.0 million shares of common stock as a dividend to the Company's equity shareholders in years 2002 through 2004, including the issuance of up to 3.0 million shares in 2002, is in the public interest because it will: (1) provide the Company with a cost-effective means of attracting, acquiring and maintaining equity capital for the funding of capitalizable additions, extensions, and improvements to its utility plant and property; and (2) increase the liquidity and marketability of the Company's stock (Exh. SU-1, at 5-6, 9; Exh. DTE 1-9).

The issuance of shares of common stock of the Company for the purposes of distributing a stock dividend to shareholders will achieve both of these objectives in a manner similar to the dividend-reinvestment plans and stock splits, previously approved by the Department. For example, the Department has approved a variety of dividend-reinvestment plans for most, if not all, of the gas and electric utilities operating in the Commonwealth. Under a dividend-reinvestment plan, a company's shareholders may elect to have their cash dividends automatically reinvested in additional shares of common stock, which are specifically issued by the company for sale through the plan. Utilities have adopted these plans because they provide a utility with "a means to provide a continuous infusion of new equity capital into the company in a cost-effective fashion." Colonial Gas Company, D.P.U./D.T.E. 97-83, at 2 (1997). Thus, in approving the issuance of stock necessary to administer these plans, the Department has found that the issuance serves a legitimate utility purpose because the proceeds from the sale of shares through the plan are available to fund additions to utility plant and to retire short-term debt

incurred for the same purpose. See e.g., Colonial Gas Company, D.P.U. 91-130, at 4 (1991); Bay State Gas Company, D.P.U. 91-170, at 6 (1991); Boston Edison Company, D.P.U. 94-150, at 6 (1994); Essex Gas Company, D.P.U. 96-121, at 5 (1997); The Berkshire Gas Company, D.T.E. 98-61/87, at 29-33 (1998).

The Company's purpose in issuing shares to effect the stock dividend is no different from the underlying purpose of the dividend-reinvestment plans approved in the past by the Department, i.e., since the Company is not paying out retained earnings to shareholders as a cash dividend, the cash generated from these earnings is available for reinvestment in utility property, plant and equipment.⁸ However, the distribution of a stock dividend achieves the objective of a dividend-reinvestment plan in a more cost-effective manner for the shareholder, because the shareholder is able to increase his or her investment in the Company without incurring the tax liability that is incurred when a cash dividend is received. With the stock dividend, the shareholder incurs no tax liability until the share is sold at a future date, which may reduce the tax liability associated with the dividend for the shareholder.⁹

⁸ As indicated by the Company, the amount of the stock dividend payment to shareholders is not dictated by the level of retained earnings on the Company's balance sheet at the time that the dividend is declared (Exh. DTE 1-19; Tr. at 43-44). At the time that the dividend is issued, however, retained earnings reflected on the balance sheet (up to the value of the stock dividend) are reclassified to "Common Shareholders Equity," thereby representing a reinvestment of retained earnings in the operations of the Company (Exh. SU-4).

⁹ As the record shows, for income-tax purposes, the proceeds associated with the sale of stock received as a stock dividend will be treated as long-term capital gains rather than ordinary income, as long as the underlying stock upon which the dividend is granted has been held by the shareholder for a period in excess of one year (Exh. SU-1, at 6). Since the long-term capital gain tax rate is significantly less than the ordinary income tax rate, shareholders have the opportunity to reduce their tax liability associated with any gain on their investment (id.).

The issuance of shares for the purpose of distributing a stock dividend also has the effect of gradually and predictably increasing the number of shares that are available to be traded in the marketplace, which in turn increases the liquidity of the Company's stock similar to the effect of a stock split (Exh. SU-1, at 6). In the past, the Department has approved stock splits for a number of utilities, which are designed to increase the liquidity and marketability of a company's stock. The Department has found that the increased marketability of a company's stock will lead to increased investment in the utility, thereby facilitating future financing at a lower cost to the benefit of the utility's customers. See, e.g., Fall River Gas Company, D.P.U. 87-160/87-193, at 3-5 (1987); Fall River Gas Company, D.P.U. 93-147/93-172, at 7-8; Colonial Gas Company, D.P.U. 92 106, at 6-7 (1992). A key component of the Department's approval of stock splits has been that: (1) the issuance of additional shares of common stock does not result in a change in the aggregate value of the utility's common stock; and (2) the utility is able to satisfy the net plant test. Id.

In this case, the record shows that an important objective of the stock issuance is to maintain the marketability and liquidity of the Company's common stock (Exh. SU-1 at 6). The Company has issued stock dividends for a number of years and the Company's shareholders desire and expects the payment of a stock dividend (id.). The Company's policy of issuing a stock dividend is disclosed and discussed in all major financial reports of the Company and a change in this policy is likely to have the effect of diminishing the value of the Company's equity in the eyes of its shareholders (id.). As a result, the marketability of the Company's shares is linked to the Company's ability to maintain its stock-dividend policy. In addition, the gradual

and predictable increase in the number of shares has the effect of enhancing the liquidity of the Company's stock (id.).

With respect to its ability to attract and maintain capital, the Company's practice of issuing a stock dividend enables it to compete successfully in the equity markets by attracting investors who have a preference for stock dividends over cash dividends. The issuance of stock for a dividend distribution also maintains the Company's ability to use the cash generated by earnings to improve and expand its utility operations, which reduces the level of financing that would otherwise be required by the Company (Tr. at 42-43). For example, the record shows that, as of March 31, 2002, the Company has a debt-to-equity ratio for its capital structure reflecting 65.6% long term debt (assuming preferred securities are treated as long-term debt) (Exh. SU-18; Tr. at 74-75). The record also shows that the market expects the Company (and other LDCs) to have a reasonable level of common equity in their capital structure (Tr. at 42).¹⁰ Therefore, if the Company did not distribute the stock dividend, and was unable to use retained earnings for deleveraging and self-financing purposes, then the Company would have to access the capital markets by issuing equity (id. at 40-41). However, the cost of raising capital through an equity issuance would be more expensive than issuing stock for a dividend since the dividend distribution allows the Company to avoid brokers' commissions and other costs associated with the issuance of equity (id. at 41). The record further shows that the Company's investors, rating agencies and lenders recognize this fact by providing the Company with more favorable debt interest terms (id.). Accordingly, the issuance of up to an aggregate of 10.0 million shares of

¹⁰ See Blackstone Gas Company, D.T.E. 01-50 (2001).

common stock for the purpose of distributing a dividend to the Company's equity shareholders provides the Company with a cost-effective means of attracting, acquiring and maintaining equity capital for the funding of capitalizable additions, extensions, and improvements to its utility plant and property, and therefore, should be approved by the Department.

Lastly, the record shows that the issuance of additional shares has no effect on the per-share par value of the Company's stock or on the total value of the shareholders' equity in the Company (Exh. SU-1 at 7; Exh. SU-3 [revised]). The per-share par value does not change because retained earnings reflected on the Company's books at the time of the dividend are first applied to increase equity capital at a level equal to the par value of the stock issuance, with the remaining balance of retained earnings (up to the value of the dividend) being transferred to paid-in surplus. In addition, the Company has demonstrated that following the issuance of up to an aggregate of 10.0 million shares of common stock, the Company's net utility plant will exceed its total capitalization, consistent with Department precedent (Exh. SU-3 [revised]).

In its decision approving the 2001 stock issuance, the Department found that issuing stock for the purposes of acquiring and maintaining equity and increasing the liquidity and marketability of a company's stock is a "legitimate utility purpose" as contemplated by G.L. c. 164, § 14. Southern Union Company, D.T.E. 01-52, at 9 (2001). Accordingly, the issuance of stock to effect the dividend payment meets the first prong of the Department's two-part standard.

B. The Company Has Demonstrated That Its Net Utility Plant Will Exceed Its Total Capitalization Following the Stock Issuance.

In approving stock splits, the Department has stated that any gas or electric company seeking Department approval of a proposed stock issuance must establish that such financing is reasonably necessary to accomplish some purpose in meeting that company's obligation to provide service to the public. See e.g., Fall River Gas Company, D.P.U. 87-160, 87-193, at 3 (1987). The Department has further stated that this is so even where a proposed stock issuance does not increase the total amount of a company's capitalization or indebtedness.¹¹ Id.

In this case, the record indicates that, following the issuance of up to an aggregate of 10.0 million shares of common stock necessary to effect the stock dividend in 2002, 2003, and 2004, the Company's will have net-utility plant in excess of total capitalization of approximately \$146,797,000 (Exh. SU-3 [revised]). The record also shows that, although the issuance of the stock dividend has the effect of reducing the per-share book value of the Company when the dividend is issued, there is no reduction in the aggregate book value of the stock to the Company's shareholders because the shares are issued to all stockholders on a pro rata basis so that the relative percentage of ownership held by each shareholder is unchanged (Exh. DTE 1-6). This outcome is similar to a stock split, i.e., the total capitalization of the Company remains unchanged as a result of the stock issuance. The only difference in this case is that, for purposes of the net plant test, an adjustment is made post-issuance to increase Common Stockholders' Equity by the amount of retained earnings on the Company's books (up to the

¹¹ In order to approve stock issuances subject to G.L. c. 164, § 14, the Department must determine that no impairment of the capital stock will occur pursuant to G.L. c. 164, § 16 (see DTE-RR-7).

value of the dividend). Since the Company has demonstrated that its net utility plant is in excess of its capitalization following the issuance, there is no impairment to the Company's capital stock as a result of the reclassification of retained earnings to Common Stockholders' Equity. In fact, the reinvestment of net earnings in the Company's operations will increase the level of net utility property, plant and equipment on an annualized basis (Exhibit SU-5).

As discussed above, the Company has demonstrated (consistent with the requirements of the Department's net-plant test) that its net utility plant equals or exceeds its total capitalization and will continue to do so following the proposed issuance, pursuant to G.L. c. 164, § 16. See New England Power Company, D.T.E. 00-53, at 10; Boston Edison Company, D.T.E. 00-62, at 9-10. Therefore, the Department should authorize and approve the Company's request to issue up to an aggregate of 10.0 million shares of common stock as a dividend payment to the Company's equity shareholders in 2002, 2003, and 2004, of which not more than 3.0 million shares would be issued for the purpose of effecting the stock dividend in 2002.

C. The Company's Proposed Issuance of an Aggregate Number of Shares Is in Accordance with G.L. c. 164, §§ 14 and 16.

The issuance and distribution of up to an aggregate 10.0 million shares of common stock for the purpose of effecting a stock dividend in 2002, 2003 and 2004, is in accordance with G.L. c. 164, §§ 14 and 16, and is consistent with Department precedent on the approval of stock option plans. In approving stock-option plans, which requires the issuance of common stock shares of the Company at the time that options are exercised, the Department will approve an aggregate, maximum number of shares to be issued throughout the term of the plan, based on a

single filing. See e.g., Essex County Gas Company, D.P.U. 94-164 (1994) (authorizing a maximum of 100,000 shares of stock for purposes of a ten-year stock option plan). Similarly, the Company has calculated that it will issue up to 10.0 million shares of stock for distribution as a stock dividend in 2002, 2003 and 2004. The Company currently anticipates continuing its stock-dividend policy into the future, although the Department's approval would not preclude the Company from changing its dividend policy, and is faced with an administrative process in issuing the stock dividend, which is complicated by the need to obtain annual approvals from the Department.

As background, there are several issues involved in seeking the Department's authorization for the issuance of stock to effect the dividend. When a stock dividend is issued, accounting rules require that the Company retroactively adjust all per share balances, as if the stock dividend occurred in the earliest period presented (Exh. DTE 1-8). Therefore, Southern Union coincides the annual stock dividend with the end of the fiscal year (i.e., June 30th) (id.). The timing of the issuance of the stock dividend allows the Company to adjust the per share information provided to shareholders in the June 30 annual report (id.).

The issuance of the stock dividend process is initiated with a vote by the Board of Directors on or about June 1 to declare the stock dividend. Prior to declaring the dividend on June 1, the Company must coordinate the regulatory and administrative requirements of The New York Stock Exchange (which requires three-days prior notification of the declaration date), the Company's transfer agent (who initiates a "broker search" to identify shareholders as of the record date) and other parties involved in the stock issuance (id.). The record date is

usually 7 to 10 days after the date of declaration and the payable date is usually 10 to 14 days after the record date (id.).

To secure the Department's approval of the stock issuance in accordance with this structured timeline, the Company relies on financial information from the period ending December 31 (i.e., the most recent public financial information prior to the June 1 dividend declaration date) (Exh. SU-1, at 4-5).¹² Given that the Company's primary business is gas distribution, the Company's financial results will vary significantly between the December 31 reporting period and the March 31 reporting period. However, to conform with the timely necessary to achieve Department approval of the Company's proposed stock issuance by June 1st, the Company must justify the stock issuance to the Department based on financial data that does not provide the Department with relevant information on the status of the Company's financial operations, including updated totals for retained earnings as of the latter half of the peak winter season.

The Department has already determined that issuing stock for the purposes of a stock dividend (and retaining earnings to fund capital additions and extensions of utility plant) is reasonably necessary to accomplish a legitimate utility purpose and has established that the issuance does not affect the overall capitalization of the Company. Therefore, it is unlikely that the Department's review in a proceeding in the next three years would yield a contrary result

¹² In accordance with the regulations of the Securities and Exchange Commission ("SEC"), the Company's financial information for the reporting period ending March 31 cannot be publicly released until the Company's 10-Q is filed with the SEC. The Company's filing was made to the SEC on May 14, 2002 and has been provided to the Department as Exh. SU-4 [revised].

that causes the denial of the stock issuance.¹³ Moreover, the Department will have the opportunity to maintain oversight of the Company's financial operations through long-term debt financings and other filings that will occur over the next three years, for which the Company is required to obtain Department approval. In addition, the Company will file annual reports with the Department detailing the actual number of shares issued, the level of retained earnings available at the end of the fiscal year (June 30), and the status of the net-plant calculation in accordance with Department precedent following the distribution of the dividend each summer. This would provide the Department with the opportunity to request that the Company make a filing for pre-approval of the stock issuance in the next year (notwithstanding any authorization given in this proceeding), should the Department determine that additional review is required.

VII. CONCLUSION

The record in this proceeding shows: (1) that the Company's issuance of up to 10.0 million shares of common stock to provide a dividend payment to the Company's equity shareholders in 2002, 2003, and 2004 is reasonably necessary to meet the Company's service obligations, pursuant to G.L. c. 164, § § 11 and 14; and (2) that the Company's net-utility plant equals or exceeds its total capitalization (as calculated consistently with the Department's precedent on the net-plant test) and will continue to do so following the proposed issuance, pursuant to G.L. c. 164, § 16. Therefore, for the reasons stated above, the Department should:

¹³ In fact, the Department's review is expressly limited to the standard for stock issuances under G.L. c. 164, § 14, because the stock dividend is allowed under G.L. c. 164, § 11, where a company demonstrates that it has met the Department's standard under G.L. c. 164, § 14. Accordingly, it is not the policy of issuing a stock dividend that is under review by the Department, but rather the Company's ability to satisfy the standard for a stock issuance.

VOTE: That the issuance and distribution of up to an aggregate 10.0 million shares of common stock as a dividend payment to Southern Union shareholders in 2002, 2003, and 2004, of which up to 3.0 million shares will be distributed in 2002, is reasonably necessary for the purposes for which such issuance and distribution has been authorized, pursuant to G.L. c. 164, § 14.

VOTE: That the issuance and distribution of up to an aggregate 10.0 million shares of common stock as a stock dividend, with no more than 3.0 million shares issued in 2002, is in accordance with G.L. c. 164, § 16 in that the fair structural value of the Company's property, plant and equipment and the fair value of the gas inventories held by the Company, will exceed its outstanding stock and long-term debt.

ORDER: That the issuance and distribution of up to an aggregate of 10.0 million shares of common stock is approved and authorized, contingent upon the Company's certification of a vote by the Board of Directors to authorize the stock issuance; and

ORDER: Such other and further orders and approvals as may be necessary or appropriate.

Respectfully submitted,

SOUTHERN UNION COMPANY

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Dated: May 20, 2002